

BEFORE THE  
DEPARTMENT OF TRANSPORTATION  
WASHINGTON, D.C.

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1999 U.S.-ITALY COMBINATION SERVICE CASE

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Docket OST-98-4854

BRIEF OF  
CITY OF PHILADELPHIA, DIVISION OF AVIATION

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**I. INTRODUCTION AND OPENING ARGUMENT**

**A. History of the Proceeding**

Pursuant to the Department's Notice of November 16, 1998, three carriers have applied in the 1999 U.S.-Italy Combination Service Case for U.S.-Italy service and the seven weekly frequencies available to the United States on April 1, 1999: American Airlines applied for Chicago-Rome service, Delta Air Lines for Atlanta-Rome service, and US Airways for Philadelphia-Milan service. In addition, the City of Philadelphia, Division of Aviation ("Philadelphia"), the City of Chicago ("Chicago"), and the Georgia and Atlanta Parties ("Atlanta") have participated in this proceeding in support of new Italy service from their respective airports. Direct and rebuttal exhibits have been filed and, with the submission of these briefs, the case stands ready for decision by the Department.

In many ways, this proceeding is unique among DOT carrier selection proceedings. The reason is the expectation that the current U.S.-Italy aviation

agreement, which limits U.S. carrier service to Italy and forces DOT to choose among three worthy services, soon will blossom into an Open Skies agreement, thus freeing DOT from selecting carriers and gateways that the marketplace is best equipped to judge.

There is no doubt that each of the three U.S. carriers that have submitted service proposals in this proceeding deserves to inaugurate the U.S.-Italy service it seeks. Similarly, there is no doubt that each of the communities involved in this proceeding also deserves the new nonstop service which its hub carrier is proposing. And, finally, there is no doubt that each of these services will increase competition and add to the public benefits in the U.S.-Italy and U.S.-Europe markets. All three services deserve to be operated and, undoubtedly, will be operated when the United States and Italy conclude an Open Skies agreement.

The challenge now before the Department, admittedly a difficult one, is to select the one proposal which, through the combined characteristics of the carrier, the U.S. gateway, and the Italian gateway, will maximize the public benefits to the United States in the short run, i.e., until a U.S.-Italy Open Skies agreement comes in effect.

It is the position of Philadelphia that the public benefits, including inter-carrier and inter-gateway competition, are maximized in this proceeding by the award of seven frequencies to US Airways to operate Philadelphia-Milan service.

**B. DOT Must Select the “Right” U.S. Carrier, the “Right” U.S. Gateway and the “Right” Italian Gateway**

**1. The “Right” U.S. Carrier: US Airways is the Smallest Carrier to Europe Among the Three Applicants in this Proceeding. Only by Selecting US Airways Will the Department Maximize U.S.-Italy Competition**

The Department's choice of carriers in this proceeding is very clear: It is a choice between the largest (Delta) or second largest (American) U.S. carrier to Europe, with service proposals that provide little, if any, competition for Alitalia or US Airways -- a relative newcomer to Europe -- which proposes the only new head-to-head U.S.-Milan competition with Alitalia.

In addition to being the two largest U.S. carriers to Europe, both American and Delta already have extensive European alliances in place. Delta has no fewer than eight European airlines with which it code-shares -- Aer Lingus, Air France, Austrian, Finnair, Malev, Sabena, Swissair and TAP. American currently has four European code-share partners in place -- Air Liberté, British Midland, Iberia and LOT -- and a major global alliance with British Airways awaiting regulatory approval. And, of course, American is a founding member of the “oneworld” global airline network with five charter members -- and more to come.

By contrast, US Airways operates fewer than ten daily departures to Europe, not even a mere shadow of the European services offered by American or Delta. US Airways has no transatlantic code-share partner. Indeed, its only European code-share partner, Deutsche BA, is a small, regional carrier serving four points in Germany under its code-share agreement with US Airways.

In conclusion, US Airways is the “right” U.S. carrier to be selected in this proceeding.

**2. The “Right” U.S. Gateway: Philadelphia is the Smallest U.S. Gateway in this Proceeding. Only by Selecting Philadelphia Will the Department Maximize U.S.-Italy Competition**

The Department's choice of U.S. gateways, similar to the Department's choice of airlines, is between two of the largest -- Atlanta and Chicago -- or Philadelphia, which has merely a fraction of the international services enjoyed by Atlanta or Chicago. From Atlanta, Delta operates 28 international services, including 14 services to Europe. In addition, four of Delta's European code-share partners also offer service between Atlanta and Europe. Overall, Atlanta enjoys 33 international services.

Despite sharing its Chicago hub with United, American operates 11 European services from Chicago. In addition, American's partners and potential partners (Iberia, LOT and British Airways) serve Chicago. Overall, Chicago receives 42 international services.

Philadelphia, the nation's fifth largest metropolitan area, receives only eight European services from US Airways and only 18 overall international services.

In conclusion, Philadelphia is the “right” U.S. gateway to be selected in this proceeding.

**3. The “Right” Italian Gateway: Milan, Not Rome, is the Italian Gateway That Most Deserves New U.S. Carrier Service. Only by Selecting Philadelphia Will the Department Maximize U.S.-Italy Competition**

Finally, in choosing an Italian gateway, the record before the Department is unchallenged: Milan is the leading Italian city for business and industry, as well as the economic center of the entire Southern Europe/Mediterranean Region. In addition,

Milan, not Rome, is the Italian gateway most in need of new U.S. carrier service which would put U.S. flag carriers in a position to counter Alitalia's recent shift of the majority of its U.S.-Italy service from Rome to Milan.

In conclusion, Milan is the "right" Italian gateway to be selected in this proceeding.

**II. US AIRWAYS OFFERS THE ONLY OPPORTUNITY TO INCREASE U.S. CARRIER COMPETITION TO ITALY**

**A. *The US Airways in This Proceeding is Not the Same Carrier as The Former USAir***

Since US Airways' current management team assumed its position three years ago, US Airways has undergone an extensive transformation from a virtually "domestic-only" carrier without the corporate structure or instinct to compete with the airline industry's elite carrier, to a carrier positioning itself to become both a leading domestic and international carrier. The current management team has revamped every aspect of the airline, including a livery and name change, a fleet renewal and expansion order, and the upgrade of US Airways' entire information technology systems.

Despite these efforts, several of the parties have suggested that US Airways' small international presence is a reflection of US Airways' management decision to build the carrier's domestic network at the expense of growing its international route network. This is far from the truth. As both American and Delta well know, a U.S. carrier cannot grow internationally without first putting the proper domestic connections and hub in place. Consider how slowly Delta grew Cincinnati internationally or American grew Dallas-Fort Worth internationally before those carriers put a full domestic hub in place.

The reality is that US Airways is aggressively growing its European services. In 1998 alone, new services were added from Philadelphia to London, Paris and Amsterdam. From Pittsburgh, new service was added to Paris. US Airways also attempted to begin Charlotte-London service, but had to delay inauguration of the service because of an inability to obtain appropriate slots at London Gatwick. In addition, US Airways placed an order for up to 30 new A-330 aircraft, and redesigned its premium service product to reflect the demands of today's international traveler. Thus, notwithstanding the suggestions of the other parties, US Airways has and will continue to demonstrate a serious commitment to international services.

***B. US Airways is, by a Significant Margin, the Smallest Carrier in This Proceeding***

Despite all the positive changes that have occurred at US Airways, it remains the smallest U.S. transatlantic carrier by any measure. Among the carriers in this proceeding, the gap between US Airways and the other two applicants is significant. Whether one looks at passengers, seat miles, revenue miles, cities served, number of flights or any other statistic, US Airways is the smallest U.S. transatlantic carrier (US-R-101-133).

**A Transatlantic Comparison of American, Delta and US Airways**

	<u>Delta</u>	<u>American</u>	<u>US Airways</u>
RPMs (millions)	18,473	14,248	3,547
ASMs (millions)	23,522	17,778	4,479
Block Hours (000)	221	193	46
Departures (000)	28	22	6
Seat-Departures (000)	6,050	4,391	1,141
Airport Pairs	37	26	9
U.S. Gateways	3	8	2
European Gateways	24	12	7
Revenue (millions)	\$2,155	2,036	354
Operating Profits (millions)	\$274	215	24

Twelve Months Ended June 1998  
Source: US DOT Form 41/US-R-101

Currently, Delta serves 14 European points from Atlanta -- a number that will increase to 17 in Summer 1999 (Philadelphia 401); Delta has its Atlantic Excellence partners, consisting of Austrian, Sabena and Swissair; and Delta has a significant code-share agreement with Air France and smaller code-share agreements with other European carriers, including TAP and Malev. Delta and its primary European code-share partners (Austrian, Sabena and Swissair) operate between eight U.S. gateways and 24 European points. On an annual basis, these carriers generate 25 billion RPMs and 31 billion ASMs (US-R-121). These already significant operating statistics are increasing as Delta's newest code-share partner, Air France, has added several new services between the United States and France.

American's European route network is nearly as large as Delta's, with over 260 weekly departures to Europe among 28 city-pairs, plus a well-developed alliance network that will only grow with the eventual addition of British Airways.

In contrast, US Airways has only nine daily European services and no transatlantic code-share partners. And, as we show later (infra at p. 17) and as is most pertinent to the selection of the "right" carrier in this proceeding, American and Delta are, today, able to offer their passengers multiple one-stop, on-line access to both Rome and Milan either via their own networks or via their partners' European networks. In contrast, US Airways' passengers have no one-stop, on-line service to Milan.

***C. The Department's Congressional Mandate Requires Selection of US Airways***

As the Department assesses which carrier in this proceeding should be awarded new Italy authority, it must pay careful attention to the overriding Congressional mandate to foster an increase in competition.

The absolute size disparity between US Airways, on the one hand, and Delta and American, on the other, requires the Department to apply Congress's mandate in determining whether its decision is in the public interest. Specifically, Congress required that the Department work toward "the continued strengthening of small carriers to ensure a more effective and competitive airline industry" (49 U.S.C. §40101(a) 13). The Department also must consider the effect of selecting a larger carrier on the overall competitive landscape of the U.S. airline industry and the prevention of unreasonable concentration in the industry (49 U.S.C. §40101(f)).

The legislation requiring DOT to be cognizant of the overall industry structure was enacted specifically to direct the Department to rectify the huge imbalance in international service opportunities that exists between carriers of the size and scope of American and Delta, on the one hand, and smaller carriers, such as US Airways, on the other. Otherwise, Congress feared that all international services would be concentrated in and controlled by the two or three largest U.S. carriers.

Although Congress's mandate to DOT is nearly seven years old, it has never been more applicable than it is today. The size advantages of the U.S. carrier international "haves" is virtually insurmountable for those U.S. carriers that are international service "have-nots." American and Delta, with their extensive European services and strategic alliance partners, account for nearly 47% of all U.S. carrier European departures. An award of additional service to either carrier would increase the already dangerously high level of concentration in the U.S.-Europe market and would be directly contrary to Congress's intent.

**D. US Airways' Receipt of an Italy Award in the Most Recent Italy Route Proceeding Evened the Italy Playing Field Only with American, Not Delta**

US Airways received its first Italy service less than three years ago by virtue of the award by DOT in the 1996 U.S.-Italy Route Proceeding. Delta has suggested that, because US Airways "won" the last case, the Department should not award a second limited-entry Italy service to US Airways before American or Delta receives a new service. Delta's contrived "policy" argument falls short of both good policy and a fair reading of the current U.S.-Italy competitive landscape.

In most cases, the concept of not awarding successive limited-entry routes to the same carrier has a sound basis in policy. In a large sense, it is a practical way of implementing Congress's mandate by "spreading the wealth" among many U.S. airlines. The concept has no application, however, in the present situation because neither has the "Italian" wealth been spread among U.S. airlines nor has the U.S.-Italy playing field been leveled.

The 1996 award of Philadelphia-Rome authority to US Airways did not confer any special advantage on US Airways; it simply leveled the U.S.-Italy playing field (based on frequencies only) with American. After that award, US Airways merely had in the U.S.-Italy market what American had -- a single U.S.-Italy route -- albeit five years after American had received its Chicago-Milan rights. As a result, both American and US Airways now have a single, limited-entry service to Italy. American still retains, however, an overwhelming advantage over US Airways in terms of European services (Philadelphia-R-108). In fact, American operates more European services from Chicago alone than US Airways operates to Europe in total.

As to Delta, the 1996 Philadelphia-Rome award to US Airways did not level the playing field between US Airways and Delta. Delta today enjoys two daily JFK services to Italy with unlimited frequencies. Thus, not only does Delta already operate to both Milan and Rome, but it does so from the largest U.S. O&D point to Italy (the largest by far) and without any frequency limits to either Italian city. Were Delta to receive the seven weekly frequencies at stake in this proceeding, Delta would receive its third Italy service before US Airways had a second Italy service. Even without awarding Delta new authority in this proceeding, it would take an award of considerably more authority than US Airways is seeking in this proceeding to level the Italy playing field with “Italy-authority rich” Delta.

***E. An Award to Either American or Delta Adds Little Public Benefit***

All of the applicant carriers will argue that awarding them the valuable authority at stake in this proceeding is in the public interest, and it would be. The real question is: Which service proposal maximizes the public benefit. The reality is that an award to American or Delta does little more than add an additional European service to those carriers' already extensive international route networks. In Delta's case, no other U.S. carrier would have as much Italy service as Delta (Indeed, Delta already has more Italy authority today than either US Airways or American.) American also has extensive European authority and several European alliance partners. Moreover, consummation of American's alliance-in-waiting with British Airways will further strengthen American's European dominance. On the other hand, an award to US Airways would represent only its tenth European service.

Despite its small size, relative to American and Delta, US Airways has not shown any hesitation to compete with American, Delta or any other international carrier given the tools -- route authority -- to do so. This willingness by US Airways to compete is what Department officials must be alluding to when they speak about increasing inter-carrier competition. By awarding additional services to the largest carriers or gateways, the Department's objective of increasing competition is not met. Only by introducing new competitors into the market is inter-carrier competition promoted. Thus, it is clearly in the public interest to award US Airways the Philadelphia-Milan authority it seeks in this proceeding.

### **III. PHILADELPHIA OFFERS THE GREATEST PUBLIC BENEFITS AS THE RECIPIENT OF NEW U.S.-ITALY SERVICE**

Philadelphia remains convinced that each applicant has demonstrated a compelling need for service to Italy from its selected U.S. gateway. Philadelphia, however, offers a number of advantages over the other gateways in this proceeding that makes selection of Philadelphia-Milan service the decision that maximizes the public benefits.

#### **A. Philadelphia has the Greatest Population of Italian-Americans of Any Gateway in This Proceeding**

No matter which Census Bureau statistics are used, Philadelphia has the greatest concentration of Italian-Americans of any community in this proceeding (Philadelphia 207; R-138; US-R-401). Philadelphia is located in a state with one of the highest concentrations of Italian-Americans (Philadelphia 204), and Philadelphia is

located in the center of the region of the United States where nearly half of all Italian-Americans live (Philadelphia 208).

Philadelphia's Italian-American population, when measured against Chicago and Atlanta on an "apples-to-apples" basis, is 35 percent larger than Chicago's and 12 times larger than Atlanta's (Philadelphia 201, 205, 207). Philadelphia's metropolitan area is second only to New York among U.S. cities in Italian-American population (Philadelphia 203). This large Italian-American population enjoyed by Philadelphia has stimulated ethnic, cultural, business and other ties between Philadelphia and Italy (Philadelphia 212). The many ties between Philadelphia and Italy continue to generate new demand for air travel between Philadelphia and Italy. Some of this demand is satisfied by US Airways' Philadelphia-Rome service, but many Philadelphia passengers to Italy must either drive to other U.S. gateways (e.g., Newark to catch Alitalia, JFK to use Delta or Washington Dulles for United's service) or make interline connection in Europe.

At the state level, Pennsylvania has a significantly larger population of Italian-Americans than either Illinois or Georgia. On a regional basis, Pennsylvania also is located in a region where over 40% of all Italian-Americans live (Philadelphia 202, 206). In contrast, fewer than 14 percent of all Italian-Americans live in the Southeast (Philadelphia 209). Fewer than nine percent of Italian-Americans live in the Midwest (Philadelphia 210).

Atlanta suggests that ethnic ties are not important as a decisional factor in a route proceeding because the United States is a "melting pot of a nation of immigrants" (ATL-R-100 at 2). The fact is that ethnic populations do matter, should be and are an important decision criteria in route case awards. Ethnic communities generate a steady

year-round demand for air travel. Large ethnic communities have attracted air carriers to begin service in many markets. For example, LOT Polish Airlines' service to Chicago benefits Chicago's large Polish community; Royal Jordanian's service to Detroit provides convenient access to the Middle East for the large Arab-American community living near Detroit; and Aer Lingus's Boston-Ireland service is frequently used by the numerous Irish-Americans in Boston returning to Ireland for visits.

While Atlanta may not understand the significant traffic generated by a large ethnic community to its homeland (or want to understand its importance because of Atlanta's relatively low ethnic demographics), the Department has recognized the traffic demand generated by ethnic communities. In the 1996 U.S.-Italy Service Proceeding, the Department noted:

It [Philadelphia] also has the largest population of Italian ancestry of any of the proposed gateways, and of any other U.S. city except New York. Ethnic and economic ties demonstrate a strong community of interest between Philadelphia and Italy, as does the fact that Philadelphia has historically been the most popular destination for Italian visitors of any of the proposed gateways .... Moreover, Philadelphia is located in the center of the populous eastern seaboard region that generates the most passengers to Italy.

(Order 96-2-35 at 6).

What was true in the prior proceeding remains true today. Of the three gateway communities participating in this proceeding, Philadelphia has the strongest ethnic ties to Italy.

**B. While the Northeast May Have More Service to Italy Than Other Regions, it is Because it Generates More Italy Traffic Than Any Other Region**

Throughout its Direct and Rebuttal Exhibits, Delta claims the Southeastern United States and the Southern Tier of the United States as its own, and complains repeatedly that the South lacks nonstop service to Italy. It is true that the Southeast has no U.S. flag service to Italy; however, there is good reason for this lack of service: The Southeast is not a large generator of O&D traffic to Italy (Philadelphia-R-111). Aside from Florida, the remaining states in the Southeast have very small Italian-American populations and generate almost no traffic to Italy. Even when Delta tries to claim the entire Southern tier of the United States as its own, instead of just the Southeast, that collection of 13 states produces only slightly more than 21 percent of all U.S.-Italy traffic, although 30 percent of all Americans live there. By contrast, the six states that surround Pennsylvania produce over 40 percent of all U.S.-Italy traffic with only 18.5 percent of the total U.S. population (Philadelphia-R-110).

**Comparison of Population and Italy O&D Traffic**

	<u>Southern Tier</u>	<u>Mid-Atlantic</u>
Number of States	13	6
Percent of U.S. Population	30	18.5
Percent of U.S.-Italy O&D	21	42.4

Philadelphia does not dispute Delta's oft-repeated claim that it serves more points in the Southeast over Atlanta than either American over Chicago or US Airways over Philadelphia (DL-R-118). That being said, so what? The fact is that the Southeast region produces little traffic to Italy. This is a U.S.-Italy proceeding, not a "Service to the

Southeast U.S.” proceeding. While Delta may claim Meridian, Mississippi as its own, Meridian and virtually three quarters of the points that Delta serves in the Southeast via Atlanta produce almost no Italy O&D traffic, once Delta's overly inflated forecast is adjusted (see pages 25 to 27, infra). All of the largest traffic producing points in the Southeast are served by US Airways over its Philadelphia hub (Philadelphia-R-113). In fact, US Airways offers single-connect Italy service to over 90 percent of the Southeast's O&D traffic -- all of it with less than 5 percent circuitry (Philadelphia 416, R-113). In 16 communities, from Raleigh-Durham to New Orleans, travelers already reach Rome with convenient US Airways service via Philadelphia (Philadelphia-R-113).

While it is true that Florida produces a significant amount of U.S.-Italy traffic, that traffic is concentrated in six markets -- Fort Lauderdale, Jacksonville, Miami, Orlando, Tampa and West Palm Beach. All of those markets already receive at least two daily connecting services to Italy from one of the four U.S. carriers serving Rome -- Delta via JFK, US Airways via Philadelphia, Continental via Newark and TWA via JFK. US Airways' current Rome service accesses 98 percent of Florida-Rome O&D over Philadelphia (Philadelphia-R-114). To the vast majority of Florida-Rome passengers, Delta's Atlanta-Rome service proposal offers nothing new.

**C. Philadelphia is Underserved as a Gateway Compared to Atlanta and Chicago**

Throughout both its direct and rebuttal exhibits, Atlanta stressed that the lack of Italy service at Atlanta has retarded Delta's ability to grow its large hub, as well as Atlanta's ability to attract new business or economic development (ATL-R-1). Neither claim is accurate. The reality is that Atlanta has a level of European air service far in

excess of what a city with a population of fewer than four million people should expect to receive. For every thousand of population, Atlanta enjoys 1.93 European departures (Philadelphia 402). Chicago, with a population of close to nine million, receives only 1.35 European departures per thousand of population.

Compared to Chicago, but especially Atlanta, the citizens of Philadelphia remain woefully underserved. With a metropolitan area population of slightly more than six million, Philadelphia receives only 0.59 European departures per thousand of population. Although Chicago is roughly one-third larger than Philadelphia, it receives nearly double the level of European departures. Atlanta, with a population one-third less than Philadelphia enjoys more than three times more service per thousand of population than Philadelphia.

***D. Even Without Nonstop Service to Rome, the Citizens of Atlanta and Chicago Have a Larger Number of Service Options to Italy Than the Citizens of Philadelphia***

Delta's and Atlanta's complaining that the lack of nonstop service between Atlanta and Italy hinders business development in Atlanta and makes it difficult for local residents to travel to Italy simply is without merit. Local Atlanta residents who wish to travel to Rome have multiple daily Delta or Delta-related options, and can continue to earn Delta frequent flyer miles under all of these options. Specifically, Atlanta's local passengers can choose daily Delta service via JFK to Rome or Milan (Philadelphia-R-105).<sup>1</sup> In addition, local Atlanta passengers can fly to Italy via Delta's or its alliance partners' European gateways in Brussels, Paris and Zurich, either on Delta or the flights

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<sup>1</sup> Contrary to Atlanta's inaccurate rebuttal exhibit, during the summer when Delta's JFK-Rome service operates twice daily, Delta's second flight operates on a single-plane basis from Atlanta to Rome (see Delta's June 1, 1998 Timetable).

of its alliance partners. In addition to these multiple travel options on Delta and its three alliance airlines, Atlanta receives one-stop, on-line Italy connections from three other European carriers (British Airways, KLM and Lufthansa) and four U.S. carriers (Continental, TWA, United and US Airways) (Philadelphia-R-106-107).

For Chicago travelers, the options are even more numerous, with single-carrier, one-stop Italy service offered by 14 carriers -- American, Air France, Alitalia, British Airways, Continental, Delta, Iberia, KLM, Lufthansa, Sabena, Swissair, TWA, United and US Airways (Philadelphia-R-106). American's frequent flyers can earn AAdvantage miles on its alliance partners' services to Italy, except on British Airways.

By contrast, Philadelphia travelers have very few service options to Milan, and no opportunities to earn Dividend Miles. Aside from U.S. flag service from Continental, Delta, TWA and United, only two non-U.S. flag carriers serve Philadelphia -- British Airways and KLM.

In sum, Atlanta citizens have 50 percent more options to Rome and Milan than Philadelphia citizens, Chicago citizens have more than double the number of service options to Rome, and almost double the number of Milan one-stop, on-line services available to Philadelphia citizens.

**On-Line, Single-Connect Services to Italy**

<b>Gateway</b>	<b>Milan</b>	<b>Rome</b>
Chicago	11	14
Atlanta	9	9
Philadelphia	6	6

Source: Philadelphia-R-106-107

**E. The Size of a Carrier's Hub is Not Relevant, What Matters is Local Traffic and Location, Location, Location**

Delta devotes a significant portion of its direct and rebuttal exhibits boasting about the size of its Atlanta hub (DL 122-128; 132-139). Chicago also boasts about the size of its airport (ORD-R-101-109). The reality is that the size of an individual carrier's hub or the local airport is not relevant to the Department's determination of which carrier offers the greatest public benefits. What is relevant is how much local traffic the hub community can generate and what percentage of the behind-gateway traffic reasonably connects (both in terms of schedule and circuitry) at the hub airport. In Delta's case, the fact that it operates over 800 daily flights at Atlanta throughout the day in several banks does not hold much significance for the local Atlanta-Rome market or Delta's ability to generate Rome traffic. Notwithstanding Delta's attempts to bolster the local Atlanta-Rome market by using wildly inflated market growth and stimulation rates, Delta's local Atlanta-Rome market simply is not larger than either Philadelphia's or Chicago's local market to Rome. Delta's percentage of properly adjusted, properly forecast local traffic is the lowest of any gateway in this proceeding (Philadelphia-R-128). In fact, Delta's local market comprises the smallest percentage of total onboard traffic of all the carriers in this proceeding.

<b>Carrier</b>	<b>% of Local Market Share of Total Traffic</b>
<b>US Airways</b>	31.5
<b>American</b>	30.7
<b>Delta</b>	24.4

Source: DL 301; AA 301; US 302

Philadelphia's central location in the Mid-Atlantic Region makes Philadelphia the ideal gateway for U.S.-Italy traffic. Over 96 percent of U.S.-Italy travelers can travel via Philadelphia to Italy with less than 15 percent circuitry added to their trip (Philadelphia 412). Neither Atlanta nor Chicago even comes close to matching the penetration of the U.S.-Italy traffic pool that Philadelphia enjoys. US Airways' hub at Philadelphia penetrates nearly 83 percent of U.S.-Italy traffic with less than 15% circuitry (Philadelphia 416). By contrast, American's hub at Chicago and Delta's hub at Atlanta each penetrates only about 40 percent of U.S.-Italy traffic (Philadelphia 417-418). Atlanta's penetration is even more limited, with just over 10 percent of U.S.-Italy traffic located within its convenient connecting zone of less than five percent circuitry (Philadelphia 418).

Atlanta's suggestion that circuitry is not an important factor to passengers simply is wrong (ATL-R-100). Simply denying a well-known and proven fact does not make it go away. The fact that so little U.S.-Italy O&D traffic is present in the Southeastern United States means that the majority of passengers are located in other regions of the United States -- the Northeast and Mid-Atlantic. Thus, an award to Delta at Atlanta provides virtually no public benefits to the regions of the country where the vast majority of U.S.-Italy traffic is located. For other European markets, where the demand for travel is more evenly distributed, it makes sense to evenly distribute gateways throughout the United States.

Circuitry does matter, and Delta, Atlanta's hub carrier, knows that. Indeed, both Delta and Atlanta have relied on circuitry analyses in other route proceedings when it

avored their position. In the U.S.-Chile Combination Service Proceeding, Delta attacked Continental's Newark gateway by noting:

Another quarter of Continental's proposed behind gateway cities would require a back-haul to travel to Chile. For example, Washington, D.C. is Continental's largest forecast behind-gateway city, representing 33 percent of Continental's entire behind-gateway forecast. To travel on Continental, traffic would have to endure a 180-degree backhaul and, in the case of Dulles passengers, a small commuter airplane.

(Brief of Delta Air Lines, September 30, 1997, at 24).

Atlanta recognized the validity of circuitry analyses as a decisional factor in the same proceeding:

Two potential new gateways are offered in this proceeding – Newark by Continental, and Atlanta by Delta. As a connecting point in South America, the New York airports are not geographically well positioned. Only New England and Northern states can connect to South American flights [at Newark] without circuitous routings. To serve a broad U.S. market, connecting service for South America needs a southern gateway... Recognizing that Newark is simply too far north to be a viable connecting gateway for most of the United States, we analyzed proposed connecting services mentioned in CO-217 in our exhibit, ATL-R-103, showing very clearly that of 97 connections touted in CO-503 for Newark-Santiago, only 18 look like real connections that are not either too circuitous, one-way, or both. Of those 18 markets, 11 are served by propeller commuter aircraft (DL-R-144). That leaves only 7 markets that have non-circuitous roundtrip online jet connections as part of Continental's proposal. Geographically, Atlanta is well-positioned for feed traffic to and from South America.

(Brief of the Georgia and Atlanta Parties, September 30, 1997, at 5-8).

Most important, the Department has recognized that circuitry issues do, in fact, deserve decisional weight. In the 1990 U.S.-Japan Gateways Proceedings, DOT noted:

...The biggest impediment to the award of Houston authority, however, is the proposal offered by Continental... We also perceive the structural benefits of this service as minimal. Most connecting markets would involve significant circuitry...

(Order 90-10-15, at 16).

Again, more recently in the U.S.-Toronto Service Proceeding, DOT acknowledged circuitry as an important factor:

Although TWA correctly points out that Pittsburgh is already a relatively well served O&D market, our tentative decision relative to the respective service benefits of the applicant carriers was based primarily on the fact that USAir's hub at Pittsburgh serves a large catchment area with minimal circuitry to Toronto, enabling USAir to take full advantage of Pittsburgh's location.

(Order 95-11-1, at 5).

Despite Atlanta's efforts to distract from its geographic disadvantage and the relatively insignificant amount of Italy O&D traffic in the Southeast by criticizing Philadelphia's circuitry exhibits, the Department must not be fooled into believing an award to Delta produces any public benefits to the vast majority of U.S.-Italy passengers. Public benefits are maximized by providing the new service in the region of the country where the traffic is located and where behind-gateway traffic is collected. That region is the Mid-Atlantic, and Philadelphia is in the center of the region with minimal circuitry.

#### **IV. MILAN IS THE ITALIAN GATEWAY THAT SHOULD RECEIVE ADDITIONAL U.S. SERVICE**

Because the U.S.-Italy market remains a limited entry market, it is critical that the Department not only select the “right” U.S. carrier and the “right” U.S. gateway, but also the “right” Italian gateway. Indeed, selection of the “wrong” Italian gateway would diminish the public benefits that DOT is required to maximize. The Department is faced with selecting between two Italian gateways -- Milan or Rome. Without question, the benefits of selecting Milan are far greater to the United States than selecting Rome.

##### ***A. Milan, Not Rome, is Where the Economic Action is***

Milan is located in the Lombardy Region of Italy. Lombardy is one of the most economically advanced regions, not just in Italy, but in all of Europe. As Philadelphia’s 300 series direct exhibits demonstrated (without rebuttal from any other party), the Lombardy Region is unequalled as the economic capital of Italy and Southern Europe.

No other region of Italy approaches Lombardy in terms of the economic and demographic strengths. The Lazio Region -- where Rome is located -- has a GDP that is about one-half the size of Lombardy (Philadelphia 304). Lazio has only one-half the number of businesses of Lombardy, less capital investment and considerably less involvement in international trade than Lombardy (Philadelphia 305-309). In short, Milan, not Rome, is where Italy’s economic action is and where future growth will occur.

##### ***B. Milan is Where the Traffic is . . . Today and Tomorrow***

In recent years, Milan has positioned itself to become the center of the Southern Europe/Mediterranean Region. Newly opened Malpensa Airport near Milan is but one example of the focus of attention on Milan, not Rome. In fact, the Rome applicants’ only criticism of Milan is that it now has more service to the United States than Rome, and,

therefore, the Department should award service to the lesser used gateway. If that were a valid criticism, then this case would be over because both Atlanta and Chicago have more services to Europe than Philadelphia, and adopting the lesser-used gateway theory would result in the Department awarding the new Italy authority to Philadelphia.

What none of the Rome parties acknowledges is the reason Milan has more service than Rome: viz., Alitalia, recognizing that Milan, not Rome, is where the economic action in Italy is and will be, and recognizing that Milan, not Rome, will be the future gateway to Italy, switched its primary intercontinental hub from Rome to Milan. While Philadelphia has provided substantial evidence as to Milan's status as a leading European business center (Philadelphia 300 Series), no exhibit that Philadelphia could have prepared sends as strong and as clear a message about where the traffic growth in Italy will take place as Alitalia's decision to move its intercontinental hub from Rome to Milan (Philadelphia 312).

Among the three applicants and service proposals in this proceeding, only US Airways' service proposal injects new carrier competition in the U.S.-Milan market. Alitalia's decision to switch its primary Italy gateway strengthens Alitalia's position as the largest carrier in the U.S.-Milan market. Only US Airways proposes to compete with Alitalia's new services. Because Alitalia offers the most service between the United States and Milan, it will attract a premium share of high-yield traffic, while having discarded the relatively lower-yield leisure passenger (and seasonal traffic) to U.S. carriers serving Rome. Only by selecting US Airways can the Department attempt to correct the sudden service imbalance in the U.S.-Milan market that is now present.

**C. Unlike American and Delta, US Airways' Service Proposal Addresses the Important Market Structure Issues Necessary for Maximizing Public Benefits**

The Department's concern for overall U.S.-Italy market structure is one of the primary reasons that the Department selected US Airways in the 1996 U.S.-Italy Service Proceeding. In that proceeding, the Department acknowledged that US Airways' "Philadelphia service will have the most significant competitive impact on Alitalia's services, because US Airways' Philadelphia gateway is an effective competitor to Alitalia's primary U.S. gateway in New York" (Order 96-2-35, at 8). Since that recognition of Philadelphia as an important inter-gateway competitor, Philadelphia has grown only stronger as US Airways has added additional services at PHL.

At the time of its Philadelphia-Rome application, US Airways' service proposal not only provided important benefits to U.S. communities, but also provided important benefits to the overall competitive position of U.S. carriers vis-à-vis Alitalia. Because of Alitalia's primary gateway switch from Rome to Milan, US Airways is the only carrier in this proceeding with a service proposal that, again, improves the overall competitive position of U.S. carriers versus Alitalia.

Unless the Department selects US Airways' proposal to serve Philadelphia-Milan, there is a reasonable chance that Alitalia will establish an insurmountable market dominance in the important U.S.-Milan market. Thus, unless US Airways receives the authority to serve Milan, no additional U.S. carrier service to Milan will be available to check Alitalia's growth in the critically important U.S.-Milan market.

**V. THE FORECASTS OF BOTH DELTA AND AMERICAN OVERSTATE THE AMOUNT OF TRAFFIC THAT THEY WILL CARRY**

**A. Delta Believes That Bigger is Always Better in the Local Market**

Delta's forecast, like its schedule, is premised on the theory that the largest passenger forecast, whether credible or not, is best. The first of the many problems with Delta's forecast is Delta's calculation of the local Atlanta-Rome market. Delta's adjusted forecast for the Atlanta-Rome market is 53,846 annual O&D passengers. This represents over 3,800 annual passengers more than is forecast by American for its Chicago-Rome service, which serves a local population more than twice as large as Atlanta's and has an Italian-American population nearly 10 times greater than Atlanta's (Philadelphia-R-T1). It is also nearly 15,000 passengers larger than the Philadelphia-Rome market, which already has nonstop service (Philadelphia-R-T1). In short, Delta's forecast of the local Atlanta-Rome market is unrealistic and unachievable in the extreme.

If Delta's proposed Atlanta-Rome O&D traffic is compared to other U.S.-Rome gateways on a per capita basis, Delta's overstatement of its local market O&D becomes obvious. According to Delta's forecast, Atlanta, without any nonstop Italy service, has 14.62 Rome passengers per thousand of population. This is an increase of 10.37 passengers per day from the base year number (Philadelphia-R-125, 127). Among U.S. cities, only New York, with five daily Rome services, has a higher number of Rome passengers per thousand of population with 16.63 passengers. Again, Delta's local Atlanta forecast simply cannot be considered reliable or credible.

Delta's Atlanta forecast also is overstated because Delta used an excessive stimulation rate -- 175 percent (Delta 302). While Delta and Atlanta consider this

stimulation rate conservative, in reality it is much too high given the existing O&D traffic base (Philadelphia-R-126). Delta justified its 175 percent stimulation rate by averaging the stimulation rates of other European markets that Delta entered from Atlanta. Delta's forecasting flaw lies in the fact that the other European markets used -- Amsterdam, Madrid, Manchester, Munich, Shannon and Vienna -- had base year O&D figures between three and five times smaller than the Atlanta-Rome base year O&D figure. In the case of Shannon, the base year traffic was only 510 passengers (Delta 306). Rather than Delta's 175 percent stimulation rate, a more realistic stimulation rate for Atlanta-Rome, consistent with actual stimulation rates in other U.S.-Rome markets, is 41 percent, i.e., less than one-fourth the stimulation rate Delta used (Philadelphia-R-126).

***B. Delta's Behind-Gateway Stimulation Rates  
"Create" Traffic That Will Never Materialize***

In addition to Delta's unrealistic 175 percent Atlanta-Rome stimulation rate, Delta compounds its overstatement of traffic because of the excessive and unachievable stimulation rates that Delta applies to behind-gateway markets. Delta "creates" traffic that simply is not present today and will not be present were Delta to begin Atlanta-Rome service. Delta's combination of excessive growth and stimulation rates results in market growth stimulation rates as high as 91 percent (Philadelphia-R-119).

Delta's stimulation rates simply are unrealistic. Under Delta's proposed forecast, traffic between the United States and Rome for points included in its forecast increases by 31 percent over base year traffic. This increase simply is not attainable because Atlanta is not well positioned to capture U.S.-Italy traffic and because most significant

U.S.-Italy traffic points already receive U.S.-Italy service over other gateways. Delta already accesses over 79 percent of U.S.-Rome traffic via its daily New York-Rome service (Philadelphia-R-103). Delta's behind-gateway stimulation rates result in some astounding traffic projections.<sup>2</sup> For example, Tucson, located 1,541 miles from Atlanta and with no Atlanta non-stop service, sees its Rome traffic grow by nearly 88 percent in Delta's forecast.

In order to demonstrate the overstatement associated with Delta's forecast, Philadelphia recalculated Delta's forecast to all markets to which Delta provided single-connect roundtrip service within a 15 percent circuitry band of Atlanta. Philadelphia lowered the growth and stimulation rates between Atlanta and Rome to a more reasonable and realistic 10 percent growth rate -- the rate used by US Airways -- and a 41 percent local market stimulation rate as explained above. Philadelphia then removed all behind-gateway stimulation. Under Philadelphia's recalculated Delta forecast, Delta would carry nearly 70,000 fewer passengers than its forecast indicates (Philadelphia-R-128).

***C. Delta's Revised Service Proposal Provides Orlando-Rome Passengers Nothing New***

Delta's revised service proposal to offer change-of-gauge service to Orlando should be afforded no decisional value by the Department. The service proposed by Delta is no different than services offered today between Orlando and Rome on Continental, TWA, US Airways, or even on Delta over its JFK hub. Were Delta to implement its proposed Orlando-Atlanta-Rome service, its Orlando-Atlanta-Rome

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<sup>2</sup> In contrast, US Airways uses no behind-gateway stimulation in order to present a more credible forecast for the Department to evaluate (US 302).

passengers would have the same travel experience as Delta's Orlando-JFK-Rome passengers have today (Philadelphia-R-109). On the outbound trip, passengers at Orlando would board an airplane. At either JFK or Atlanta, checked baggage would be transferred, and passengers would disembark from one aircraft and board a second aircraft. On the return trip, Orlando-bound passengers would disembark at either Atlanta or JFK, clear customs, recheck their luggage and board a different aircraft at a new departure gate. Thus, in practice and reality, Delta's revised proposal provides no new benefit to Orlando passengers. In fact, change-of-gauge service could actually mislead passengers who believe that a single flight number flight is identical to single-plane service.

In addition, Delta's projected stimulation rate for the Orlando-Rome market is 75 percent (Delta 302). This 75 percent stimulation rate is simply not achievable in a market that is already well known in Italy for its numerous leisure and tourist attractions and already has connecting service from all four U.S. carriers that currently serve Rome. Delta justifies this excessive stimulation rate because Delta's revised service proposal will offer change-of-gauge, single flight number service between Orlando and Rome via Atlanta. Were Delta to have kept its original service proposal -- Orlando-Atlanta-Rome same-plane service -- a 75 percent stimulation rate might have been "forecast defensible," but it is not achievable under Delta's current service proposal given the level of identical service already in the market.

***D. Delta Already Offers Both Rome and Milan Service from New York . . . Delta's Forecast However Shows No Diversion From New York as a Result of Starting an Atlanta Service***

Before awarding Delta its third U.S.-Italy service and second U.S. gateway to Italy, the Department must carefully consider Delta's significant Italy operating rights from New York. Providing daily service to Rome and Milan from the largest U.S.-Italy O&D point, Delta is free of the restraints on its Italy service that other U.S. carriers face with their Italy services, including US Airways, which prevent them from expanding service at their gateways. Delta is free to increase its frequencies between New York and Italy to any commercially viable number and to serve Italy with no restrictions on aircraft size. In fact, just last week, Delta announced that it will operate its second New York-Rome service on a year-round basis (Aviation Daily, January 6, 1999). This means that Delta will have three daily services to Italy compared to just one for US Airways. And, Delta could go to four daily services, or five or six, if it wished. Notwithstanding all of Delta's advantages at New York, Delta asks the Department for yet more U.S.-Italy service in this proceeding. And, from a forecasting perspective, Delta asks for this new service without providing the Department any indication of how much traffic currently flowing over New York would be diverted to Atlanta, i.e., diverted from a "frequency unregulated" U.S.-Italy market (a right for which the U.S. Government has paid dearly) to a "frequency regulated" U.S.-Italy market. The number of diverted passengers will be considerable (Philadelphia 419; R-128).

Even by Delta's own admission, its passengers prefer Atlanta to New York (DL 129; Philadelphia-R-122).<sup>3</sup>

**E. By Delta's Own Admission, the Size of Delta's Atlanta Hub is Not Relevant**

Delta includes a significant number of direct and rebuttal exhibits touting the size of its Atlanta hub. There is no question that Delta has built a large and powerful hub in Atlanta. The Department should only concern itself, however, with those aspects of the Delta hub directly related to its proposed Atlanta-Rome service. Delta implicitly acknowledges this fact in its rebuttal exhibit submission by recasting the number of roundtrip, single-connection services to Rome from Atlanta (DL-R-103). In essence, Delta has agreed that the only flights relevant to this proceeding are those that connect within a four-hour window of the operation of the Atlanta-Rome service. What this means is that Delta's boasting about the size of its Atlanta hub (DL 122-128; 132-139), the number of points it serves in the Southeast (DL 122), the number of points it serves in the Southern tier of the United States (DL 127), the number of destinations served from Atlanta (DL 112), and the number of seats offered at Atlanta (DL 133) is irrelevant to this proceeding and should not be considered by the Department. Delta clearly recognized that its schedule, much like its forecast, was overstated. Unlike its forecast, however, Delta has attempted to correct its schedule.

- In its direct exhibits, Delta claimed single-connection service between Rome and 114 points. In its rebuttal exhibits, Delta claims single-connection

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<sup>3</sup> Delta's revised service proposal calls for a 269-seat MD-11 aircraft to operate between Atlanta and Rome. Interestingly, Delta's current New York-Rome service operates with a smaller 213-seat B-767-300 aircraft, despite the fact that the New York-Rome market is over 15 times larger than the Atlanta-Rome market. Delta's New York hub serves 79 percent of all U.S.-Rome traffic with much less circuitry than its proposed Atlanta service (Philadelphia-R-103). More important, Delta's JFK service allows Delta to access U.S.-Italy traffic from the Northeast and Mid-Atlantic regions of the country where most U.S.-Italy traffic originates or is destined for.

roundtrip service only to 89 points (DL-R-103). The correct number after removing highly circuitous markets is 61 markets (Philadelphia-R-116).

- In its direct exhibits, Delta claimed it would provide the first single connection service to 46 points. In its rebuttal exhibits, Delta has lowered its claim to only 37 points. This reduces Delta's traffic by nearly 10,000 annual passengers (DL-R-104).
- In its direct exhibits, Delta claimed that it would improve elapsed times to Rome for 65 U.S. communities. In its rebuttal exhibits, Delta claims it will improve elapsed times for only 55 U.S. communities. Again, Delta did not provide an adjusted traffic forecast to reflect this revised exhibit (DL-R-106).

Philadelphia is gratified to see that Delta has recognized the flaws of its direct exhibits. Delta's overhaul of its forecasts and schedule connections underscores two points that Philadelphia has made throughout this proceeding: First, the size of Delta's Atlanta hub is not a relevant decision criteria, and, second, Delta's forecast numbers are not credible or achievable.

***F. American's Forecast Relies Heavily on Excessive Stimulation and One-Way Connect Markets***

While American has not embellished its forecast or schedule, it does rely on unreasonable stimulation rates and high levels of single-connection service to bolster its forecast. American, unlike Delta, does not attempt to stimulate individual markets by up to 75 percent. Rather, American uses a blanket 10 percent stimulation rate for all U.S.-Italy markets. This includes those points that American does not even claim it will connect to Rome. In the markets that American will serve, it applies a 10 percent stimulation rate even when American's service is only in one direction or when an interline connection is required to get to or from Chicago (AA 310). It simply is not credible to believe that American Airlines' service between Chicago and Rome will lead

to increased travel between Buffalo, New York and Rome, or Montgomery, Alabama and Rome or Washington, D.C. and Rome.

American's forecast is also heavily reliant on markets that are not roundtrip connections or require an interline connection. Given the characteristics of the Rome market -- seasonal and leisure oriented -- American simply cannot offer competitive service in those markets that are one-way connects or interline connects. A price-conscious leisure traveler simply cannot get the lowest possible fare to Rome if round-trip on-line connections are not possible. The Department should eliminate from American's forecast all markets that only connect in one direction or require interline connections.

In sum, determining the extent to which a new international service will stimulate behind-gateway markets is a difficult task. In this proceeding, only US Airways chose not to stimulate behind-gateway markets because of the difficulty of accurately doing so. American and Delta both erred in their use of stimulation rates, Delta by its use of excessive market-by-market stimulation rates, and American by using a blanket stimulation rate without regard to its quality of service or market penetration.

**V. CONCLUSION**

US Airways' Philadelphia-Milan service represents a selection of the "right" U.S. carrier, the "right" U.S. gateway and the "right" Italian gateway. An award of U.S.-Italy service to US Airways to provide Philadelphia-Milan service would best fulfill the Department's policy objectives of maximizing public benefits by increasing inter-carrier and inter-gateway competition. For all of these reasons and the reasons stated above, the City of Philadelphia, Division of Aviation urges the Department to award the seven weekly frequencies at stake in this proceeding to US Airways for Philadelphia-Milan service.

Respectfully submitted,

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